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# **Kazakhstan: Finishing the Transformation**

**By**

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[The following are excerpts of the speech Kazakhstan Institute of Management, Economics, and Strategic Research located in Almaty, Kazakhstan, on December 13, 2002.]

Kazakhstan Institute of Management, Economics, and Strategic Research (KIMEP) is producing the next generation of Kazakhstan's leaders for both government and the private sector. We are proud of our longstanding partnership with KIMEP and look forward to working with you in the future.

Since its independence in 1991, Kazakhstan has been in the midst of a remarkable transition from communism to free markets. When completed, this transformation could bring Kazakhstan into the global marketplace in a way not seen since Central Asia dominated international trade routes hundreds of years ago.

Today I want to discuss how Kazakhstan can complete its integration into the global system of trade, investment, and communication. This, I believe, is the only road to prosperity in the 21<sup>st</sup> century. Kazakhstan's current leaders are laying the foundation for its integration into the global economy. It will be the task of your generation to finish the work of building a democratic society that will unleash the full human potential of every citizen of this country. At independence in 1991, Kazakhstan had a promising resource base, from its sizable hydrocarbon reserves to its well-educated workforce. More importantly, though, it had the wisdom to move quickly away from the failed policies of the past.

Kazakhstan's leadership embarked on a new transformational course. In a little over ten years, Kazakhstan implemented a series of broad-based reforms that brought Kazakhstan from planned to a market economy. These reforms include the following:

- Kazakhstan undertook a process of de-monopolization, privatization, debt restructuring, price liberalization, customs reform, and tax restructuring.
- Kazakhstan established a securities and exchange commission, liberalized trade, enacted laws on investment, established a new government procurement process, and reformed the banking system.

The United States formally recognized this achievement when, in March of this year, it accorded Kazakhstan the status of a market economy, and these reforms yielded the following impressive results at home in Kazakhstan:

- Today Kazakhstan has a fully convertible currency, single-digit inflation, and a sound banking system.
- Foreign investment into Kazakhstan — \$12.5 billion between 1993 and 2000 — has surged.
- Both trade and investment have diversified, with the United States now the largest investor in Kazakhstan and a growing partner in trade.

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- Economic growth, though uneven throughout the last decade, has been strong in recent years.
  - Kazakhstan recently received an investment grade rating from Moody's.

The government of Kazakhstan has privatized much of the economy, although much work needs to be done to restructure major sectors such as telecommunications. The banking sector has flourished, with \$720 million in private deposits in March 2001. The financial system has been a leader in innovation, including the emergence of successful private pension funds, the establishment of a national fund to preserve oil wealth for future generations, and a budding mortgage-lending market. Unemployment, while still high in Western terms, is lower than elsewhere in the region. These impressive reforms took place against a background of internal political stability and the gradual advance of democratic reform and a civil society. We are heartened to see that economic reform is continuing.

Kazakhstan's plan to privatize farmland could become another laudable step forward, if care is taken to see that privatization is fair and transparent. The achievements of its first decade of independence have brought Kazakhstan to a critical crossroad. It can continue to move forward on the road toward reform and complete its integration into the global economy and the growing family of democratic nations. Or it can lose momentum, falter in reform, and miss an opportunity to be among the new "tigers" of global prosperity in the 21<sup>st</sup> century.

The U.S. government's preference is clear. The United States would like to see Kazakhstan accelerate and complete its integration into the global economy. We are ready for a strategic partnership with a democratic Kazakhstan. But, in the end, only the people of Kazakhstan themselves can determine which fork of the crossroads they will take. Obviously, Caspian energy resources are extremely important and give Kazakhstan an enormous advantage over other transition economies that lack natural resources. Indeed, probable reserves in the huge Kashagan field are larger than those of the entire United States. The government of Kazakhstan continues to take some important policy steps, such as having concluded a Caspian delimitation agreement with Russia this summer and moves are now underway to link Kazakhstan to the new Baku-Tbilisi-Ceyan oil pipeline.

Next year, Kazakhstan intends to offer for tender new offshore blocks in the Caspian that could yield more world-class oil discoveries. It would be a dangerous illusion, however, to believe that oil wealth can substitute for resolve to finish the course of democratic and market reform. Oil alone will not bring Kazakhstan into the new global economy. Nor will it create sufficient jobs for Kazakhstan's youth or spread the benefits of prosperity to large segments of the population that remain mired in rural poverty.

In 1995, U.S. economists Jeffrey Sachs and Andrew Warner conducted a study of 97 developing countries. They found that the more important natural resources were to a country's economy, the lower its growth rate was. Of all the resource-rich countries they studied, only two were able to grow as fast as two percent a year, while a host of resource-poor nations grew much faster. Why is this the case? The reasons are varied and complex. Part of the answer is that being blessed with natural resources can make a country less likely to take the hard policy decisions that generate investment in other sectors and unleash the individual initiative of every citizen. It can encourage behavior that is rent-seeking rather than wealth-creating. In many resource-rich countries, corruption has sapped economic growth and eroded democratic institutions. Yesterday in Astana, your leaders told me they wanted to build a post-industrial economy certainly with a vigorous energy sector but also increasingly based on high-tech, internet-based industries, and small and medium enterprises. Introducing diversity into Kazakhstan's economy and freeing its

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human potential will require a huge national effort, and a renewed commitment to democratic and market reforms, and a key objective will be making this new economy open to outside investors.

The United States has decided to support this effort through the Houston Initiative, a comprehensive partnership with Kazakhstan to build a modern, market-based economy, with particular emphasis on small and medium enterprises. We look forward to working with the government of Kazakhstan, with local governments throughout the country, and especially with individual entrepreneurs to realize the full potential of the Houston Initiative. We also hope to see Kazakhstan accelerate its bid for accession to the World Trade Organization (WTO). Kazakhstan's working party was established in 1996, and the next meeting of the group is scheduled for December 13. There remain a range of tough issues from price controls and subsidies to transparency of the legal system, to the adoption of market-consistent policies on trade in goods and services. The United States supports Kazakhstan's accession to the WTO on market terms, and we will do our best to accelerate the process.

However, the speed of Kazakhstan's accession depends primarily on the resolve and determination of its government to make the hard decisions needed to see the process through to a successful conclusion. Even as Kazakhstan seeks to accelerate its WTO bid, the hard fact is that foreign investors are increasingly worried that the government of Kazakhstan is less committed today to openness and a welcoming investment climate than it was in the years following independence. We hope that the government and people of Kazakhstan will reject economic nationalism that is at odds with your government's stated intention to accelerate integration into the global economy.

In our view, Kazakhstan simply cannot afford to pursue short-term gain at the expense of international investors and thereby jeopardize its hard-won reputation as a good place to invest. We hope to see more "win-win" thinking that produces prosperity for both international investors and the people of Kazakhstan. In this connection, it is important to avoid measures, some with the force of law, some merely administrative practice that risk creating the impression of a deteriorating investment climate. Onerous new regulations on procurement in the oil and gas industry, restrictions on the issuance of work permits for key expatriate personnel of foreign investors, and questionable environmental penalties are indicative of this trend. Even more important, many investors and the international financial press have begun to question whether a contract in Kazakhstan, once negotiated and signed, may be revisited.

We believe it is vital that Kazakhstan and foreign investors quickly find a mutually satisfactory solution to allow the proposed expansion of TengizChevrOil, consistent with contract stability. A solution that moves forward this vital \$3 billion project, which will create thousands of jobs, would be an example of the "win-win" thinking that we have in mind. I would like to conclude with a brief thought on the importance of democratic reform for economic prosperity and integration. It is no accident that almost all of the world's most competitive economies are democracies. Only democratic societies can truly liberate every individual to make a unique personal contribution to national prosperity. Thus, the building of democracy is not only the key to long-term political stability, it is also a fundamental building block of competitiveness in the modern global economy. Political pluralism, the rule of law, and respect for human rights, are just as necessary for economic development as are sound fiscal policy or a friendly investment climate. A vigorous independent media is as vital as computer literacy in the information age. An open political system permits citizens to make decisions about the appropriate level of public investment in human capital, which in turn is a key to reducing income inequality and poverty. Citizens denied fundamental civil liberties, such as freedom of speech and the right to form political parties of their choice, can hardly be expected to make informed decisions about the economic development of their country.

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There is a solid link between democracy and a pluralistic society and growth. Consider this: according to the annual *2001-2002 Survey of Political Rights and Civil Liberties*, “free” countries today account for \$26.8 trillion of the world’s annual gross domestic product (86 percent), as compared to “partly free” countries at \$2.3 trillion (7 percent) and “not free” countries at \$2.2 trillion (7 percent). This is no coincidence. Democratic societies are generally more stable than repressive ones, and the free exchange of ideas and information is good for business. Take the example of corruption, a problem worldwide. Kazakhstan also must attack this problem head on. Transparency International’s corruption index which measured business perceptions of corruption in various countries ranked Kazakhstan No. 88 out of 102 countries measured. It is clear that business people will think twice about investing where corruption is pervasive.

Transparency International also recently polled senior business executives around the globe on the most important factor that contributed to reducing corruption. The most common answer? More than half the respondents cited a free press as a brake on corrupt officials. How should Kazakhstan complete its process of transformation? You and your fellow citizens will answer that vital question. But I would leave you with a thought from U.S. Secretary of State Colin Powell:

The lessons of history are clear: market economies, not command-and-control economies with the heavy hand of government, are the best way to promote prosperity and reduce poverty.

Kazakhstan has come a long way toward the goals mentioned by Secretary Colin Powell and set by your own leaders. It remains to your generation to finish this great work. I wish you every success as you work to see Kazakhstan take its rightful place at the table of democratic nations and in the new global economy.